Stevenson Kellogg Ernst & Whinney
Management Consultants

Project Report

A REVIEW OF GOVERNMENT ACCOUNTING POLICIES AND FINANCIAL OBLIGATIONS TO MARCH 31, 1988

SUMMARY REPORT

Prepared for

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I

INTRODUCTION

A. WHAT WE HAVE DONE IN PHASE I

This is a summary report, covering Phase I of the three part review process announced on July 7, 1988 by the Minister of Finance. It reports on the results of our activities, in conformity with our proposal to the Minister dated June 28, 1988.

Stevenson Kellogg Ernst & Whinney was originally retained to guide the overall review process, and subsequently also asked to carry out Phase I. Phase II, involving an examination of management and administrative practices and program delivery effectiveness, will be put out to public tender. Phase III will involve the development of steps in support of permanent improvement in the overall financial and program management of the government of Manitoba. It will also be tendered.

Phase I was **not** a general "audit" of the government of Manitoba. Rather, it was more narrowly focused, in five specific ways:

- The core group of entities to be examined were identified for us by the Department of Finance and the Office of the Provincial Auditor.

- Several additional issues and entities were identified through collaborative discussions involving ourselves, the Department of Finance and the Office of the Provincial Auditor. It should be noted that a decision was made to exclude a number of entities of the provincial government from examination. Generally, these were smaller Crown corporations and agencies.

- Specific materiality provisions were established at the outset and agreed to by the province. Materiality adjustments of $5 million in the aggregate for 1987 - 1988 and prior periods were pursued. In practice, we gave consideration to adjustments of less than $5 million, where they presented the possibility of greater potential loss in future years. In a few instances, consideration was extended to matters which, although of lesser financial potential, represented a significant risk with respect to future losses or negative impact on overall government objectives.

- In several instances where provincial accounting practices were found to be inconsistent with **key** accounting principles, we have recommended changes; even if the resulting adjustments were below the materiality threshold.

- Examination was limited by and large to activities occurring in fiscal 1987/88. In a few instances, events occurring prior to 1987/88 were material enough to be included in our considerations. A primary example is the reinsurance problem at the Manitoba Public Insurance Corporation.

Our examinations of selected entities and issues over the designated time period, concentrated specifically on three matters. These were:

- The reasonableness of valuation allowances provided for losses which were incurred in or existed in 1987/88.

- Provincial accounting policies and practices which relate to the adequacy of the treatment or provision for valuation allowances, unfunded liabilities and other financial obligations present in fiscal 1987/88.

- The strength of financial and program management and delivery provisions. The findings relevant to these matters will be reported on in subsequent phases.

In Phase I:

- This firm completed individual examinations on eight provincial agencies and a grouped set of programs.

  - Manitoba Public Insurance Corporation
  - Workers Compensation Board
  - Manfor Ltd.
  - Manitoba Housing and Renewal Corporation
  - Flyer Industries Ltd. (divestiture)
  - Manitoba Agricultural Credit Corporation
  - Manitoba Potash Corporation
  - Manitoba Beef Commission
  - Business Loan and Investment activities carried on by the Industry, Trade and Technology Department, the Business Development and Tourism Department, and by the Manitoba Development Corporation.

- We carried out jointly with the Department of Finance, a review of four separate areas.

  - The handling of foreign exchange liabilities.
  - The accounting for and funding of civil service pensions (including Manitoba Hydro, Manitoba Telephone Systems and public school teachers).
  - Manitoba Properties Inc.

- The potential exposure for the unfunded liability of certain external agencies receiving financial support from the Community Services Department and others.

► We commented upon nine entity or issue reviews by the Department of Finance on:

- The Criminal Injuries Compensation Board
- Hudson's Bay Mining and Smelting Mine at Ruttan Lake.
- The Jobs Fund (Development Agreements and the Film Manitoba Program).
- The Manitoba Energy Authority
- The provincial policies on employee benefits: sick leave, vacation policy, severance pay and workers' compensation.
- The Public Schools Finance Board.
- The Hazardous Waste Corporation.
- The North Portage Development Corporation.
- The Manitoba Oil and Gas Corporation.

Stevenson Kellogg Ernst & Whinney also performed preliminary reviews of:

► A. E. McKenzie Company Limited.

► Leaf Rapids Town Properties.

► Co-op Credit Unions (Stabilization Fund and Fond de Securite).

We also completed interviews with the Deputy Minister or the most senior available executive, of 18 additional provincial government departments or agencies.

Details on how we conducted our examinations and arrived at our conclusions are contained in the individual project reports. These individual reports were submitted in an appendix, which you have reviewed in draft form.

B. WHAT THIS SUMMARY CONTAINS

This summary is based on our examination, in different ways, of some 43 separate entities or issues. Of these, some 30 produced results significant enough to be reported upon in this summary. They are:

- Foreign Exchange Practices
- Manitoba Housing and Renewal Corporation
- Manfor Ltd.
- Manitoba Agricultural Credit Corporation
- Manitoba Beef Commission

- Manitoba Potash Corporation
- Business Loans and Investments
- Venture Capital Program
- Hudson Bay Mining and Smelting - Ruttan Mine
- Leaf Rapids Town Properties Limited
- The Jobs Fund (Development Agreements and the Film Manitoba Program)
- Manitoba Energy Authority
- Public Schools Finance Board
- North Portage Development Corporation
- Hazardous Waste Corporation
- Manitoba Oil and Gas Corporation
- Venture Manitoba Tours
- Channel Area Loggers
- Emergency Interest Rate Relief
- Communities Economic Development Fund
- Manitoba Mineral Resources
- Manitoba Water Services Board
- Criminal Injuries Compensation Board
- Manitoba Public Insurance Corporation
- Worker's Compensation Board
- Manitoba Development Corporation (divestiture of Flyer Industries Ltd.)
- External Agencies
- Manitoba Properties Inc.
- Civil Service Pensions
- Civil Service Employee Benefits

For these individual projects which were our responsibility, we sought the assistance of chartered accountants with relevant experience in the specific subject areas. These services were arranged for by a sub-contract with Thorne Ernst & Whinney, our accounting affiliate. Thorne Ernst & Whinney staff also assisted with the preparation of this summary. The persons involved with each of the individual reports are identified therein.

This **summary** contains our findings concerning:

- ► Recommended changes to certain aspects of provincial government accounting practices and policies.

- ► Adjustments to be made as valuation allowance provisions for fiscal 1987/88, or as prior period adjustments.

We have worked closely, during this entire project, with a Steering Committee composed of the Deputy Minister of Finance or his representatives, and the Provincial Auditor or his representatives. As well, we have had the benefit of continuous consultations with staff members of the Department of Finance. The Provincial Auditor's Office made staff available for consultation,

when requested to do so. Each of the individual project reports have been examined by officials of the Provincial Auditor's Office and the Department of Finance. Thus, in a very true sense, this report is the result of a collaborative effort. We make this point not in any way to dilute responsibility for the contents of this summary -- which is obviously ours -- but to acknowledge the very real contributions made by many provincial officials.

The work contained herein represents an intense effort by a number of management consultants, chartered accountants and civil servants over a short period of time. Inevitably, this timeframe will have its effect. We have come to as many specific conclusions and offer as many precise recommendations as we prudently can, given the time and the information available. In some instances, further study is required. Fortunately, the subsequent phases of this overall review process will provide both the opportunity and the context within which much of this work can be planned and completed.

We appreciate the opportunity to be of service.

II

HIGHLIGHTS

- In Phase I, in co-operation with the Department of Finance, we examined some 43 entities and issues; of which 30 produced results significant enough to be reported on in this summary.

- Details on the main findings are contained in an appendix, which the Minister of Finance is reviewing.

- We examined provincial government accounting practices and policies, in the light of the evolving standards and guidelines from the Public Sector Accounting and Auditing Committee (PSAAC) of the Canadian Institute of Chartered Accountants (CICA), and as against the standards of Generally Accepted Accounting Principles (GAAP), published by the CICA. We have also been sensitive to the annual recommendations of the Office of the Provincial Auditor.

- We identified five key areas in which provincial accounting policies and practices should be further modified. These are:

  - greater use of accrual accounting and less use of the cash method; and a change in the means of calculating foreign currency debt liability.

  - making timely and more inclusive valuation allowances.

  - prudent valuation of those assets held by the province for sale.

  - reflecting significant unrecorded liabilities in the public accounts.

  - including in the government financial statements ("consolidating") the financial position of those entities for which the government has ultimate responsibility for their financial affairs and use of resources.

- A major review of the government's unfunded pension obligations, which are in excess of $1 billion, is urgently required; to set the framework for corrective action.

- We recommend:

  - as at March 31, 1988, a write-down of assets or valuation allowances of $367.7 million.

  - liabilities adjustments of $709.0 million.

This is a total of $1, 076.70 billion, allocated as follows:

- adjustments to expenditures (deficits) for fiscal 1987-88 of $110.2 million.

- adjustments to the expenditures (deficits) for years prior to fiscal year 1987-88 of $966.5 million.

► These steps will provide a foundation for Phase II of the overall review process.

III

ACCOUNTING STANDARDS, TRENDS AND ISSUES: AN OVERVIEW

This project involved the application of generally accepted accounting principles and standards, to specific situations. Inevitably these specific treatments will attract attention. But in a very true sense, our most important recommendations have to do with future directions for provincial accounting policy and related financial practices. The specific accounting treatments we recommend can also have **long term** significance, if they are seen as opportunities to bring the province more into line with developing accounting policies, and the directions recommended by the Provincial Auditor.

In order to assist the majority of readers who are not accountants, to understand more fully the issues and choices in this field, we have provided some background and definitions of the standards and key accounting concepts we used.

A. THE OBJECTIVES OF ACCOUNTING STANDARDS: EVOLVING TRENDS

In its broadest sense, the purpose of accounting is to communicate meaningful financial information. Meaningful to whom, and for what purpose, are usually topics of debate.

Ross M. Skinner, in his introduction to **Accounting Standards in Evolution** puts it this way:

"Accounting is a practical occupation. It has little point unless it serves a purpose. Some people -- a small minority -- find some satisfaction in the symmetry of a balanced set of accounts. But for most people the value in accounting lies in the information that it conveys.

"Thus, accounting results may furnish information useful for decision making by management or by others with an interest in the reporting entity. Take this one step further to aggregate the financial information reported by significant entities or subsets of entities within a society, and you may have information relevant to social policies. Entity accounting data may also be used directly as instruments of social policy -- as in the application of income and other taxes, price regulations, and so on."

The Financial Accounting Standards Board (FASB) in the United States has devoted a great deal of effort in developing a conceptual framework for financial reporting. It has issued two Statements of Financial Accounting Concepts dealing with the objectives of financial reporting, one for business

enterprises, and one for nonbusiness enterprises. Both Concepts Statements set out objectives that focus on the usefulness of financial reporting for making decisions.

From Concepts Statement 1, Business Enterprises:

"Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities, and are willing to study the information with reasonable diligence."

From Concepts Statement 4, Nonbusiness Enterprises:

"Financial reporting by nonbusiness organizations should provide information that is useful to present and potential resource providers and others users in making rational decisions about the allocation of resources to those organizations.

"Financial reporting should provide information to help present and potential resource providers and other users in assessing the services that a nonbusiness organization provides and its ability to continue to provide those services."

The fundamental point is that financial reporting is not an end in itself, but is intended to provide information that is useful in making sound decisions.

1. Evolution

Accounting is not a static art -- it has grown and changed in response to the economic environment and the needs of users. Naturally, the availability of more resources in the form of computing power has made new methodologies feasible.

To quote Skinner again:

"Forty years ago, when I entered accounting practice, we were still fighting battles to require a systematic provision for depreciation regardless of whether a year's results were good or bad, and to prevent the charging of arbitrary provisions for "reserves" against income. Now, forty years later, the issues have changed radically, but the struggle for better financial reporting continues. Accounting standards today cover more territory and deal with much more complex issues. Yet no one would claim that we are close to resolving all possible points of contention. Accounting standards have evolved over time and will continue to evolve -- hence the title of this book." **(Accounting Standards in Evolution).**

2. Standard setting in Canada

If accounting standards are to grow and adapt to new conditions and circumstances on a timely basis, the process cannot be left to chance. Accounting standards in Canada are set by the Canadian Institute of Chartered Accountants (CICA), through various committees. The Accounting Standards Committee deals with standards for business enterprises. It has been in existence in a variety of forms for many years.

As the influence of government grew, CICA recognized that there was a need to examine existing accounting standards in the light of the information requirements of users of **government** financial statements. The Public Sector Accounting and Auditing Committee (PSAAC) was established in March 1981 by the Board of Governors of the CICA to meet this need.

PSAAC has 19 members, at least ten of whom are appointed from those responsible for accounting and auditing in government. This ensures that those who are most knowledgeable about the affairs of government and the effects of any proposed standards, have the greatest input into their development. The approval of at least two-thirds of the members of the Committee is required for new standards to be adopted.

PSAAC is generally recognized as the authoritative accounting standard setting body for governments in Canada. In making our recommendations to the province of Manitoba we have followed PSAAC's own hierarchy of standards (Statement 3):

"In circumstances not addressed by Public Sector Accounting Statements and Recommendations, guidance can be found in analogous CICA Handbook material, other authoritative pronouncements, research studies, accounting literature and published financial statements relating to either the public sector or analogous situations in the private sector."

Where PSAAC is silent on an issue, we have relied upon Generally Accepted Accounting Principles (GAAP) for the most relevant circumstances. In some cases we have been guided by the accounting standards practiced in the relevant parts of the private sector. Most, but not all of our recommendations meet the test of being based on either PSAAC or GAAP. Some are pragmatic solutions to what we perceive as special situations. In no instance do our recommendations conflict with clear PSAAC or GAAP statements.

We have, in every instance, attempted to balance the strict applications of the most relevant accounting guidelines with due concern for public policy objectives and the basic tenants of sound management.

B. WE RELIED UPON "GENERALLY ACCEPTED ACCOUNTING PRINCIPLES"

Generally accepted accounting principles are broad accounting principles and conventions; as well as some specific rules and procedures which have been established in a particular jurisdiction by formal recognition by a standard-setting body, or authoritative support or precedent. The most authoritative source of these generally accepted accounting principles in Canada is the **Handbook of the Canadian Institute of Chartered Accountants.** When applying generally accepted accounting principles to specific instances, professional judgment is required. This is not a cut and dried process, and this is particularly true when carrying out the following activities:

- The **measurement** of transactions and events will often involve estimates. For example, estimates may be made about the future sale value of an asset.

- The **allocation** of costs between different accounting periods, such as fiscal years, will often involve choices among several acceptable alternatives.

- The **disclosure** of details within financial statements involves striking a balance between useful summaries and providing excessive detail which make the statements difficult to read.

To quote from a recent Thorne Ernst & Whinney publication **Financial Communications from Chartered Accountants: An Introductory Guide for Users)** (page 12):

"In making all of these judgments, the guiding light is materiality -- management must decide what is significant enough to affect the decision of readers of the financial statements. Three important considerations can be drawn from this:

"1. **Financial statements are approximations.** They cannot be more accurate or reliable than the underlying estimates and allocations permit. There is often a range of acceptable judgments;

"2. **Differing accounting principles and methods may be used.** Acceptable alternatives exist; and,

"3. **Financial statements do not show current values.** Most amounts in financial statements are based on historical costs. Liquidation values may be higher (as is often the case with land purchased several years ago), or lower (as might be the case if inventory were to be sold on a "fire sale" basis rather than in the ordinary course of business).

"It is because of these limitations that generally accepted accounting principles require that financial statements contain detailed notes. They disclose important information such as:

- Significant accounting policies, especially where a choice has been made between acceptable alternatives;
- Potential costs in the form of "contingent liabilities", where there is too much uncertainty to reflect the amounts within the main body of the financial statements; and,
- Changes in accounting principles or the method of applying them."

C. WE HAVE ALSO BEEN SENSITIVE TO THE PERSPECTIVES OF THE PROVINCIAL AUDITOR

In addition to our utilization of GAAP and PSAAC guidelines, we have drawn heavily upon the past analyses and recommendations of the Office of the Provincial Auditor. In particular, we have made much use of the Auditor's three most recent annual reports. These sources of accounting policy guidance share common approaches and perspectives.

The Provincial Auditor's Office (PAO) has been a strong and consistent advocate of the move to accrual based accounting for the government of Manitoba. Significant accrual based accounting policies were first introduced into the government's accounts in 1979, and this trend has continued since then.

The PAO has been "...supportive of the direction in which the policies..." have taken. Specifically, the PAO has supported the government's recent decisions to establish valuation allowances for, or to accrue:

- Cost-shared agreement recoverables.
- Provincial tax revenues.
- The recording of payment to school divisions.
- Foreign currency losses.
- Losses on all loans, advances and long term investments.

The Auditor recognizes that the standards for government accounting and financial statement presentation are evolving. As such, he "expects the government to continue to revise its accounting policies until such time as the general standards for ... governments are fully developed." We support this

approach. The recommendations made in this report will contribute to this process.

Notwithstanding the Provincial Auditor's clear support for the accrual concept and for the government's recent moves in this direction, he continues to highlight a number of specific areas in the government's accounts where further accruals or other accounting changes should occur. We have kept these in mind at each step in the study.

In his previous annual reports to the Legislature, the Auditor has recommended that the government recognize its existing liabilities for employee benefits and pension costs, and adopt a process for recording them in its financial statements. Our review of this complex subject area makes specific recommendations for the government. We have also recommended other actions which relate to the Auditor's concerns with respect to the definition and consolidation of the government's accounting entity.

The evolving standards for government accounting in Canada and their specific application in the Manitoba context have introduced improvements in the government's accounting practices in the past. We see our recommendations as in the spirit of this progress.

D. PROVINCIAL ACCOUNTING POLICIES AND PRACTICES: 1982 -1987

In a healthy organization, accounting policies and practices are continually evolving and being improved. Certainly, this has been the case with the government of Manitoba. Since 1982, the Department of Finance and the Office of the Provincial Auditor have co-operated in identifying weaknesses and implementing required changes. It is important to note that this is background against which we have recommended additional changes. In large part, our recommendations build on and represent a continuation of changes already underway. A partial list of these recent modifications includes:

1982 ► Elimination of the Special Municipal Loan and General Emergency Fund-Reserve Account.

1983 ► Discontinuance of reserve accounts for gravel pits and road machinery.

1984 ► Write off of $51.2 million of Manfor Ltd. shares. This represented the capital deficit of Churchill Forest Industries.

► A preliminary adjustment to begin accruing costs for public schools support.

- Initiation of accrual accounting for tax revenue collected by agents.

- Improved accounting for repayment received under the Insulation Loan Program.

1986
- Initiation of accrual for interest payable on trust funds deposited with the Minister of Finance.

- Establishment of the provision for unrealized foreign currency losses.

- Initiation of a policy to amortize discounts, premiums and commission costs on long term debt over the life of the debt.

- Initiation of accrual for interest income on sinking fund investments.

- Expansion of valuation allowance, to include all loans, advances and long term investments.

- Showing the accumulated deficit on the liability side of the balance sheet rather than on the asset side.

- Identifying other balance sheet items similar in nature to the accumulated deficit; and including these with the accumulated deficit rather than showing them as an asset. Specifically these were the Serial Debentures of school divisions and districts and the securities received from the sale of land and buildings to Manitoba Properties Inc.. Both items were in part to be funded out of future appropriations from the province and hence were not true assets.

1987
- Removal of the breakdown of annual deficit between capital and operating from the income statement.

- Initiation of a process to flow losses on Crown corporations through expenditure on a one year time delay. Previously these were flowed only through the accumulated deficit.

- Finalization of the process to fully accrue the cost of public schools support.

- Write off of $185 million of loans, advances and long term investments.

- Initiation of the process to record a provision for unfunded liabilities in excess of the province's investment in an entity. This involved specifically setting up $7 million for unfunded losses on the Manitoba Development Corporation arising out of the Flyer divestiture.

E. FIVE KEY ACCOUNTING ISSUES FOR 1988

This project extends the evolutionary process by giving extensive consideration to five key accounting issues. Our findings, which are reported in the following chapter, fall into these accounting issue categories. We believe it is useful to spell out these concepts, in a way that will make them more understandable. These are:

1. Accounting Issue Number One: Continuing to make necessary changes in accounting policies

Our review has produced support for proposed changes in provincial accounting policies and has yielded an additional accounting policy change with respect to foreign exchange translation.

In general, these accounting policy changes are intended to improve the methods for recording government financial information so that a more realistic, comparative and comprehensive picture of government activity and financial position may be presented. This will help in making more accurate comparisons of the **changes** in financial circumstances from one year to the next.

This evolution, directed at achieving a more standard and yet complete presentation of the government's financial position and activities, is occurring on several key dimensions. For example:

- **Completion of the transition from cash to accrual accounting**

  In general, provincial government accounting practices have been moving to a greater use of accrual accounting -- the standard accounting approach in the corporate environment. Accrual accounting provides an organization with a truer financial picture --one that is not subject to the fluctuations typically associated with the timing of cash payments.

  Accrual can be contrasted with the cash basis of accounting, which the province has traditionally used. Here, debts are recorded in the provincial statements only when an actual cash payment is made to settle the claim. There are generally no receivables and no payables. This approach makes it difficult to build a comprehensive picture of provincial finances; or to accurately compare the true changes in circumstance from one accounting period to another.

- **Use of more realistic measurement techniques**

  In 1988, the provincial government also changed its policy to allow for more realistic measurement of the value of some of its assets. Specifically, the provincial government will now immediately write-off forgivable loans. This means that loans

that, for the most part, are not going to be repaid, will not inappropriately be represented as assets. Instead, foregivable loans will be represented as government expenses at the time they are issued.

These changes in accounting policy direction are clearly positive steps in achieving a more realistic and thorough representation of this government's financial position. They are, for the most part, being guided by the intent and pronouncements of the Public Sector Accounting and Auditing Committee (PSAAC).

2. Accounting Issue Number Two: Making Appropriate Valuation Allowances and Other Provisions

A valuation is basically an expressed opinion about the worth of an asset. It can be something as specific as a piece of equipment, or an entire enterprise. There are a great many different methods of valuation. The most appropriate method is determined by the specific objectives.

The need to make a **valuation allowance** arises in the following circumstances. Typically, the province would make an investment in a specific enterprises, such as Manfor. If, at some point, there is reason to believe there has been a "permanent impairment" or decline in the value of that asset, then this decline needs to be recorded in some fashion in the financial statements. This can be done in a number of different ways. These include writing an asset down, i.e: showing it at a lesser value than the original investment; or writing it off, that is, showing it in the books at no value at all.

A write-down (or write-off) recorded against an asset cannot be reversed as a result of subsequent profitability until divestiture occurs. This policy reflects the generally accepted accounting principle approach that any write-down is a reduction in the value of an asset, and therefore cannot be written up at a later date. We concur with the new policy, as modified.

A less extreme arrangement is to make a **valuation allowance.** A valuation allowance is an estimate of the amount by which the net realizable value has declined below the level of the original gross investment. In other words, if you were to subtract the amount of a valuation allowance from an original investment, it would produce a figure which would be the net realizable value; or the amount for which the asset could in fact be sold. In a number of instances, we have recommended new valuation allowances for provincial assets.

The Public Sector Accounting and Auditing Committee (PSAAC) policy concerning valuation allowances is that:

"Valuation allowances should be used to reflect financial assets at their net recoverable or other appropriate value."

Valuation allowances for financial assets includes such items as allowances for doubtful revenue receivables, allowances for unrecoverable loans and accrued interest, allowances for amounts recoverable only through future appropriations and allowances for the valuation of investment.

Valuation allowances are likely to become the topic of interest when there is reason to believe that there has been a change in the value of financial assets. The PSAAC policy on the changes in valuation allowances is as follows:

"Changes in valuation allowances reflect the changes in the reported value of financial assets during the accounting period and should be accounted for to ensure the impact those changes have on a government's future revenue requirements is reported on the Statement of Revenues and Expenditures. **The Statement of Revenues and Expenditures should report changes in valuation allowances in the accounting period.** Changes in valuation allowances should be reported on the Statements of Revenues and Expenditures as a specific item with the main types of provisions disclosed. The provisions relate to the main classification of financial assets, such as revenues receivable, loans and advances, and investments."

In the province of Manitoba's financial records prior to March 31, 1987, a valuation allowance was recorded to disclose losses on amounts loaned, advanced or invested in Crown entities and programs. However, this was a "balance sheet" valuation allowance only. In other words, no amounts were recorded through the expenditure accounts of the government, on behalf of any increases or decreases in these valuation allowances.

The government had decided, as at March 31, 1987, to change this policy and record the increases and decreases in the valuation allowance through their expenditure accounts in the year following the valuation allowance adjustment. This new policy, revised as of March 31, 1987, was stated as follows:

"An allowance is provided for decreases in the value of loans, advances and long term term investments, and is adjusted annually for changes that may occur in the estimated realizable value of these assets. The allowance is determined as follows:

a) Accumulated deficits of Crown corporations, agencies, boards and commissions

   i) losses covered by the allowance are reviewed to ascertain the prospect for recovery of the loss of future operations of the entity involved. Losses incurred in a fiscal year that are considered non-recoverable are incorporated in the government's estimates of expenditure in the immediately following fiscal year. If the losses are considered to be recoverable, they are still included in the

valuation allowance, however, they are not incorporated in the government's estimated expenditure in the immediate following fiscal year.

b) Allowance for doubtful accounts. The allowance for doubtful accounts is used to provide for an estimated amount not recoverable under a government loan or support program. The increase in the allowance recorded to the end of the fiscal year is incorporated in the government's estimate of expenditure in the immediately following year also."

In the above two circumstances, a one year delay in recording these losses was made by the province for practical reasons basically to do with the non-availability of timely information with respect to the March 31st year end of the province, as not all related entities have a corresponding year end. This was a transitional measure to assist with the preparation of the annual budget; and to avoid a delay that would otherwise occur in the finalization of the province's expenditure accounts at the fiscal year end.

The existing policy only covered those provincial entities that were dependent for funding on the Consolidated Fund, i.e: the general account into which provincial revenues are deposited. Corporations, such as the Manitoba Telephone System, having a rate or revenue base of their own were not normally the subject of this policy, because of the ability of these corporations to adjust rates to recover losses that have occurred. However, this would not prohibit a decision by the government to make subsidy grant payments to this type of organization, if an unusual loss were incurred. One of the transitional provisions was to include loans containing forgiveness provisions as part of the transitional adjustment, i.e: any forgiveable portion of a loan outstanding at March 31, 1987 would be written off.

In the future, the forgiveable portion of this type of loan will be funded directly from the appropriation at the time the loan is made. Only the repayable portion of the loan will be funded from the Loan Act authority. In summary, the existing policy that was set up effective March 31, 1987 for valuation allowances is as follows.

The valuation allowance will be provided for all reported losses, whether considered recoverable or non-recoverable. For non-recoverable losses, the allowance will be reversed in the following year when the write-off occurs. For recoverable losses, the allowance will continue to be carried, and should be reduced annually as recovery is effected. If the loss is considered to be non-recoverable, then the next year's expenditures will be charged with that loss.

In order to conform to the PSAAC pronouncement that valuation allowance increases and decreases should be reflected through the Statement of Revenue and Expenditures, the province has revised further their accounting policy relating to valuation allowances. The main differences between the old

policy adopted as at March 31, 1987 and the revised policy now in effect are as follows:

- Increases and decreases in the valuation allowance will be charged directly to an appropriation in the **year of determination.** Previous, such increases were originally charged to the accumulated deficit in the **year of determination,** then recorded as an appropriation expenditure in the **following** year.

- "Notational allowances" will no longer be provided. Previously, "notational allowances" were provided where an accumulated deficit existed in the entity's books, even if that loss was expected to be recovered from future operations. Under the present policy, the valuation allowance is used to reflect the province's best estimate of the net recoverable amount of the investment existing at the balance sheet date. Any increases or decreases in these valuation allowances will be recorded as an appropriation in the year of change.

The above describes the existing provincial policy at the time we began our review of the various projects, and the accounting policy change that was implemented prior to the end of this project.

The most recent statement of provincial policy is that the valuation allowance is an allowance recorded on the books of the province to represent a perceived decline, other than temporary, in the value of its assets and investments in Crown corporations, agencies, boards, and commissions, and government loans and receivables under various support programs.

Any such declines in these investments will be recorded through the current year's Statement of Revenue and Expenditures.

The provincial policy was clarified during the course of this project; and is now being formally documented.

3. Accounting Issue Number Three: Valuation of Public Assets Held For Sale

The provincial government owns a number of assets which, for a variety of reasons, are being held for sale. There are a number of accounting treatment issues and choices which typically arise in these circumstances. These include sensitivity to the effect that the strict applications of relevant accounting guidelines can have on the prosects for divestiture. These issues should be frankly acknowledged and a reasonable balance struck as between the competing factors. The assets take a number of forms and include, for example, Crown corporations which are intended for divestiture and assets which are held for sale as an inherent part of government programs.

- Crown corporations intended for divestiture.

  The province intends, potentially, to divest or privatize several Crown corporations. Specifically, we have been informed that such divestiture decisions are being considered with respect to Manfor and the Manitoba Oil and Gas Corporation.

- Assets held for sale as part of operational programs.

  A number of government entities, as an inherent part of their operational programs, specifically hold assets intended for sale. For example, as a result of obtaining security associated with non-performing loans, the Manitoba Agricultural Credit Corporation holds foreclosed properties which it intends to re-sell. The Manitoba Housing and Renewal Corporation similarly holds short-term land investments intended for sale.

Based on the status of these assets as "assets held for sale", we recommend that the accounting principles applied to these entities be consistent and reflect GAAP principles and necessary valuation allowances be instituted.

Simply stated, generally accepted accounting principles require that once a formal decision is made to sell an asset, the asset's value should reflect its value in the marketplace. More specifically:

- Assets held for sale, should be viewed as temporary and be valued at their net realizable value (as opposed to their unconsumed cost, appropriate for assets held for use).

- The measurement date for estimating net realizable value should occur at the time that management has the authority to approve the plan to divest or dispose of the asset or business segment.

Our full recommendations associated with assets held for sale are given in our individual reports.

4. Accounting Issue Number Four: Reflecting unrecorded liabilities in the provincial accounts

Unrecorded liabilities are liabilities which have been incurred by an enterprise, but have not been recorded at the period end date in the enterprise's books, for the period being examined. With respect to the province of Manitoba, an unrecorded liability would be a liability which actually **existed** at any March 31st, but was **not recorded** at March 31st in the accounts for that period. The liability may have been recorded, but in a **subsequent** period. Depending on what the liability related to, the effect of not recording incurred liabilities would

usually result in a decrease in recorded assets or a decrease in recorded expenditures.

We found three main causes of liabilities going unrecorded on the provincial books:

- The cash basis of accounting records debt only when a payment is actually made to discharge its obligations.

- Some external agencies funded by the government do not report debts the government must cover, on a timely basis.

- Crown corporations or enterprises that are supposed to be financially self-supporting incur debt they cannot satisfy from their own reserves. Further, these are not always reported to the government on a timely basis; and may not be recorded as a government liability when they are reported, because of the use of the cash accounting principle.

We have recommended proper accounting treatments of these unrecorded liabilities.

5. Accounting Issue Number Five: Consolidation of government reporting entities

The issue here is this: of all the agencies, institutions, bodies, etc. the government funds, which ones should be included in the government's financial records, and which should be left out, i.e. to have their financial position reported separately from those of the government?

In the exposure draft **Defining the Government Reporting Entity** issued in April 1988 by PSAAC, the Committee addresses the issue of defining the reporting entity. Paragraphs 13 and 14 of this Exposure Draft states:

"The government reporting entity should comprise the organizations which are accountable for the administration of their financial affairs and resources, either to a Minister of the government or directly to a legislature, and which are owned or controlled by the government.

"While many organizations that are regulated by or financially dependent on government may be influenced by government, unless there is an accountability relationship of ownership or control, as defined, such organizations would not be included in the government reporting entity. For example, most provincial governments, board-governed hospitals and universities are not owned or controlled by the government, and therefore they are excluded from the government reporting entity."

Accounting for these government organizations can be made under two methods (excerpts are taken from the Exposure Draft referred to above).

One is **consolidation**, which is a method of accounting that aggregates the accounts of government organizations line by line on a uniform basis of accounting. Reporting on a consolidated basis presents summary information compiled by combining the individual financial statements of the many organizations comprising the reporting entity. The other is the **modified equity** method.

Consolidated financial information allows users to assess the full nature and extent of all financial affairs and resources. Consolidation is the most appropriate method of accounting for organizations integral to the overall operations of government in directly performing its executive function. Such organizations include government departments, special funds and numerous government organizations that exist primarily to provide services to government.

To quote further from the exposure draft:

":19 For purposes of this Statement, a government enterprise is a government organization that has the power to contract in its own name, has a financial and operating authority to carry on a business, and sells goods and services to individuals and non-government organizations as its principle activity and source of revenue. Examples of government enterprises include organizations that provide public utilities, such as hydro-electric power, transportation such as airlines, railways, ferries and public transit, communications such as telephone, insurance and public automobile insurance, and workers' compensation and liquor distribution."

Consolidation of these government entities, using the government basis of accounting, would require conforming to the government's accounting principles. This would, for example, report their significant revenue generating physical assets as expenditures, but would retain their related long term debt. Consolidation may not, however, be the appropriate method of accounting for operationally independent, but government-owned enterprises. In these cases, a "modified equity basis" of accounting would be more appropriate. That is defined in the exposure draft this way:

":21 The modified equity method of accounting accomplishes this by accounting for government enterprises on a business basis; their accounting principles are not adjusted to conform with those of the government. The modified equity basis reports their net financial position and operating results in government financial statements. It aggregates the net assets and net income of corporations by adjusting the investment shown in the government's Statement of Financial Position, and by presenting the net income as a separate item on the government's Statement of Revenues and Expenditures.

":22 The modified equity method provides a measure of the impact government enterprises may have on government's ability to discharge liabilities or to provide financial resources for future operations. Furthermore, it reports information useful in assessing the ability of government enterprises to generate

revenues to finance their own operations and to contribute financial resources to the government."

The reporting entity was addressed in the **Defining the Government Reporting Entity Exposure Draft** of April 1988, as previously discussed. Basically, the Exposure Draft states in paragraph 08:

"Regardless of the form of an organization (i.e: whether it is a department or ministry, a Crown corporation or a government enterprise), or the nature of its activities, if the government owns or controls an organization, the government is accountable because it bears ultimate responsibility for that organization's financial affairs and the use of its resources."

This is the approach we believe the government should follow.

If the reporting entity includes various organizations, then the method of accounting for these various organizations can either be composed of a consolidation process, or a modified equity process as previously discussed.

IV

RECOMMENDED CHANGES IN ACCOUNTING POLICY AND PRACTICES

This chapter summarizes our recommendations, the associated financial provisions and relevant accounting issues for each of the entities or issues reviewed in this summary. Exhibit IV-1 summarizes the financial aspects of these changes.

1. Foreign Exchange — $212.8 million

Accounting Issue: Change in Accounting Policy

Recommendation: We recommend a change in policy for the foreign currency translation rate, to be used in the calculations of deferring and amortizing unrealized foreign currency gains and losses. Specifically, we recommend that the province use a March 31st noon day spot rate -- rather than a three year average -- to calculate foreign currency gains and losses. This change will yield a more realistic representation of the government's exposure associated with its foreign currency denominated debt.

Background:

In 1986, the province began a practice of making an annual provision for the estimated losses that will occur at the time of maturity of long-term debt payable in foreign currencies. These are primarily the Swiss franc, the Japanese yen and the West German deutschemark. The purpose of this provision is to amortize, over the life of the debt, any changes in currency values that has occurred between the debt issue and the debt maturity date.

This had been calculated, by the Department of Finance, using the average of the exchange rates in effect during the three calendar years preceding the fiscal year-end. We recommend that this practice be replaced by using the March 31st noon day spot rate for this calculation. This will have the effect of faster recognition of foreign currency losses or gains in the province's Accounts. We further recommend that the foreign borrowings reported on the province's Statement of Financial Position at each fiscal year-end be revalued, using the March 31st rate; instead of using the historic rate in effect at date of debt issue.

These changes in the method of amortization and valuation result in a net increase in the amount of loss amortized to March 31, 1988 of $193.2 million. An adjustment of $204.8 million is applied to prior years i.e: before fiscal 1987/88. On the other hand, at the fiscal year ended March 31, 1988, there is a net reduction in costs of $11.6 million. This latter adjustment is reflective of the improvement of the U.S. dollar exchange rate between March 31, 1987 and March 31, 1988.

These accounting policy changes also affect the accrual of the interest on public debt that is payable in foreign currencies, as well as the amortization of debt issue costs. The adjustment of these two items results in a further charge to prior years of $17.9 million, and an additional expenditure of $1.7 million in the fiscal year ended March 31, 1988.

In addition, we recommend that expanded use of financial strategies, including hedging and swap transactions, be considered in an attempt to mitigate the exposure associated with such currency fluctuation.

2. Manitoba Housing and Renewal Corporation $11.4 million

Accounting Issue: Valuation of Public Assets Held for Sale and Valuation Allowance

Recommendation: We recommend an additional valuation allowance for the Manitoba Housing and Renewal Corporation to reflect an appropriate valuation allowance for land inventory and loans and mortgage receivables be instituted.

Background:

Our review of the Corporation disclosed two areas in which valuation allowance adjustments are required for 1987-88 and prior years:

a) Valuation of land inventory

During the 1970's, the Corporation accumulated land for development under a land bank program, with financing provided by demand notes from the province and from the Central Mortgage and Housing Corporation. The land banking program ended in the 1970s. Since that time the carrying costs associated with the purchases have been added to the book value of the land.

In 1987, the Corporation commissioned appraisals for the majority of the land held for future development. The result was a valuation allowance of $27 million for the year ended March 31, 1987. A further allowance of $4.1 million has been identified in the fiscal year ended March 31, 1988. This was the result of in-house appraisals based on the previous year's appraisals and knowledge of recent land transactions.

Under the government's previous valuation allowance policy, this appraisal loss would not have been recorded until the fiscal year ended March 31, 1989. We recommend that this policy be changed. Valuation allowance losses should be recorded in the expenditure accounts of the government in the year the loss is incurred.

We also recommend that the Corporation include in the calculation of appraisal values the estimated costs of disposition of land, such as legal fees; as well as an allowance for the possibility of sale below appraised value. We believe that a 10% overall allowance would properly allow for both of these items. We calculate that this would require an increase of $3 million to the March 31, 1987 land valuation allowance and a decrease of $.2 million in the allowance required at March 31, 1988. This is a net change of $2.8 million.

b) Loans and mortgage receivables

The Corporation controls a loan portfolio consisting of approximately 4,000 loans totalling $126 million. We noted that Corporation has recorded as assets the unamortized balance of forgiveable loans under the critical home repair and non-profit housing programs. Experience has indicated that, while forgiveness of these loans is conditional over the length of the loan, it is a rare exception that the forgiveness is not earned.

We recommend that the Corporation establish an asset valuation allowance in its March 31, 1988 financial statements equal to the outstanding forgiveable loans. This effectively reduces the net realizable value of these loans to nil. This change in accounting policy for forgiveable loans results in a prior period adjustment of $2.9 million; and an adjustment of $.6 million to the fiscal year ended March 31, 1988.

During our review of the loans and mortgages outstanding, we concluded that a general allowance for non-collection is required. We believe that the Corporation should provide an allowance of $1 million, retroactive to March 31, 1987.

c) Summary

The following is a summary of the valuation allowances recommended for the Corporation:

	1987/88	Prior Period
Valuation of land inventory	$4.1	$ -
Land disposition costs and variance from apprisal	(.2)	3.0
Forgiveable loans	.6	2.9
Doubtful loans	-	1.0
	$4.5	$6.9

Furthermore, our review of MHRC surfaced a number of policy and programatic issues. In this regard, we recommend that all land in MHRC's inventory be appraised every three or four years. In addition, MHRC should carry out a rigorous annual review of each of its loans and mortgages to maintain realistic valuation allowances. A modern property management system is required to simplify accounting and to provide more useful financial information. MHRC should also review the advantages and disadvantages of centralized management of public housing.

3. Manfor Ltd. $127.1 million

Accounting Issue: Valuation of Public Assets Held for Sale

Recommendation: We recommend that the investment in Manfor currently reflected in the provincial government accounts be written down to the nominal amount of one dollar.

Background:

The province's equity investment in Manfor was written-down by $128 million at March 31, 1987 to reflect the accumulated operating losses of the Corporation to that date. The investment is currently reported in the province's accounts at $127.1 million. Our review of the carrying value of this investment took into account a 1987 independent appraisal of Manfor's operations, the amount of capital investment required to make the operation viable on a long-term basis, and the estimated direct and indirect costs of divestiture. We have concluded that fair presentation of the value of this investment at March 31, 1988 would require a downward revaluation and recommend that the investment be carried at a nominal value of one dollar. This is the appropriate value for an asset held for sale as a "going concern." If the intent were to close the operation and sell off the assets piece by piece, a higher valuation might well be appropriate.

4. Manitoba Agricultural Credit Corporation $10.6 million

Accounting Issue: Valuation Allowance

Recommendation: We recommend that a valuation allowance be recorded in the provincial government's accounts to reflect a bad debt allowance associated with Manitoba Agricultural Credit Corporation loans.

Background:

The Manitoba Agricultural Credit Corporation provides loans to farmers and fishermen under a number of programs. All loan accounts are reviewed on an annual basis to establish an allowance for doubtful accounts. This is used to recognize, in the accounting period, those loans whose recovery has become doubtful.

A $10.6 million adjustment, recommended for the fiscal year ended March 31, 1988, is required to increase the province's valuation allowance at March 31, 1988 to the amount determined by the Corporation at that date.

In accordance with the changed accounting policy for valuation allowance, we recommend that the loss associated with the bad debts of the Corporation be recorded in the expenditure accounts of the government in the year that the loss has been incurred. Accordingly, an adjustment of $10.6 million is required in the expenditure accounts for the fiscal year ended March 31, 1988.

5. Manitoba Beef Commission **$(8.0) million**

Accounting Issue: Valuation Allowance

Recommendation: We recommend that, based on experience to date, the valuation allowance for the Manitoba Beef Commission be reduced.

Background:

The Manitoba Beef Commission was created in September, 1982 to administer a provincial stabilization and marketing plan for cattle. At March 31, 1987, the Stabilization Fund Account reported a deficit of $28 million against advances from the province of $28.6 million.

At March 31, 1988, the deficit had been reduced to $20 million and the advances to $20.7. Consequently, a reduction of $8.0 million in the valuation allowance established at March 31, 1987 is required to reflect the recovery by the Commission of losses incurred in previous fiscal years. This results in a **decrease** of $8.0 million in the expenditures recorded for the fiscal year ended March 31, 1988.

6. Manitoba Potash Corporation **$5.4 million**

Accounting Issue: Valuation Allowance

Recommendation: We recommend that, in order to reflect the significant risk associated with the project's full development, a valuation allowance be placed against the province's investment in the Manitoba Potash Corporation.

Background:

The Manitoba Potash Corporation is a joint venture between Canamax Resource Inc. and the province of Manitoba. It was established in the 1986 - 87 fiscal year to develop potash mineral reserves in western Manitoba. Work done to March 31, 1988 included market analysis and development, engineering, technical, transportation and feasibility analyses. The Corporation's program effort in 1988 is primarily focused on seeking an

additional partner to develop and operate the proposed $540 million potash mine and production facilities. Securing a qualified mine developer/operator to start-up the mine is critical to the recovery of the province's investment.

Because there appears to be a significant risk concerning the project's full development, we recommend that a valuation allowance be placed against the province's investment in the Manitoba Potash Corporation. An additional allowance of $5.4 million is required. This increases the $.5 million allowance already established at March 31, 1987, so that the $5.9 million advanced to the Corporation at March 31, 1988 will be fully covered.

7. Business Loans and Investments **$ -0-**

Accounting Issue: Valuation Allowance

Recommendation: We recommend that no additional valuation allowances be recorded for outstanding Development Agreements and New Tourism Agreements.

Background:

Outstanding loans under the Development Agreements and New Tourism Agreements have been reviewed with officials in the Departments responsible for the programs and with the Manitoba Development Corporation. Based on the information contained in the loan files and our discussions with Manitoba Development Corporation, Industry Trade and Technology and Business Development and Tourism management staff, we have concluded that no additional valuation allowances are required.

8. Venture Capital Program **$1.0 million**

Accounting Issue: Valuation Allowance

Recommendation: We recommend that in order to reflect the probable losses associated with Venture Capital Program, that an additional valuation allowance of $1.0 million be provided in the province's accounts.

Background:

The Venture Capital Program was created in 1983 under the direction of the Department of Business Development and Tourism. Since then, the program has advanced $6.2 million to 78 separate venture capital companies. In return, the province received non-voting preferred shares in each company, carrying a 7% cumulative dividend rate, which comes into effect after a three year dividend holiday. In essence, the province has very limited opportunity to participate in any "upside" benefits of Venture Capital Program investments. The province is at risk, however, for all losses.

Valuation allowances have been previously provided for those investments that the Department believes are "permanently impaired", i.e: not realizable. This approach produces the minimal valuation allowance required. But it does not adequately take into account the "higher risk" nature of these investments and the fact that, given the structure of the program, the province will not be participating to any significant extent in Venture Capital successes. Based on this and on past experience, there is a reasonable probability that the non-reserved accounts will not be fully recovered. For this reason, we conclude that an allowance of $1.0 million is required at March 31, 1988 and recommend that it be established.

In addition, we recommend restructuring the Venture Capital Program, the Development Agreement Program and related government business assistance programs, to achieve a streamlined structure for program initiation, investment monitoring and administration. We anticipate that this would reduce overall resource requirements and increase the consistency of program management.

9. Hudson Bay Mining and Smelting (Ruttan Mine) $9.0 million

Accounting Issue: Valuation Allowance

Recommendation: We recommend that a valuation allowance be instituted to represent the possible loss associated with the provincial government's interest in Ruttan Mines.

Background:

A Jobs Fund loan of $10 million was made to Sherritt Gordon Mines in 1984 to finance the operations of the Ruttan Mine. In July 1987, the loan was transferred to Hudson Bay Mining and Smelting, which had purchased the mine, in order to avoid its closure. At the time of transfer, the loan was converted to a net profits interest in the mine. The province has a right to 50% of the cumulative net profits earned during the remaining life of the mine. Closing is projected to occur in 1991-92.

The book value of the loan at that time stood at $10.7 million, including accumulated interest. However, at the time the transfer was approved, it was estimated that the province would only realize $1.7 million from its original loan if the mine were to be closed.

As a result of extraordinarily high copper prices since the loan was converted, the province has received $4.2 million as its share of profits made to March 31, 1988. Because of a concern that it may have to be returned before the end of the project, this money has been held in reserve. This could result from a downward movement in copper prices to more traditional levels. In addition, when the mine does close, the province is obligated to pay closure costs that exceed the limit negotiated between the province and the mining

company in the transfer agreement. A current factor in the assessment of this investment is the workers' strike at the mine. This began in June, 1988 and continues.

An assessment of these factors indicates that the investment is substantially at risk. The investment was acquired by conversion of a loan, which had an estimated realizable value at date of conversion of $1.7 million. It is recommended that the investment be written down to that amount. The write-down is chargeable to the fiscal year ended March 31, 1988 since the loan conversion occurred in July, 1987.

10. Leaf Rapids Town Properties Ltd. **$3.5 million**

Accounting Issue: Valuation Allowance

Recommendation: We recommend that a valuation allowance be established to acknowledge the probable losses associated with Leaf Rapids Town Properties, Ltd. due to its economic dependence on Ruttan Mine.

Background:

Leaf Rapids Town Properties Ltd. acts as a developer and operator of commercial and non-commercial properties in the Town of Leaf Rapids. Non-commercial properties include the recreation centre, municipal offices and health centre. The Town of Leaf Rapids is economically dependent, to a large extent, on the continued operation of the Ruttan Mine. As noted above, the estimated life of this mine runs to 1991-92.

The province funded the Corporation by the purchase of share capital of the Corporation for $2.6 million and by debenture loans of $3.6 million. The province's share equity in the Corporation was written-down by $.6 million at March 31, 1987, to recognize the operating losses of the Corporation to that point.

We recommend that a valuation allowance of $3.5 million be placed against the remaining value of the shares owned by the province ($2.0 million) and against the income debentures ($1.5 million) included in the debenture debt of the Corporation held by the province. This allowance acknowledges the uncertain realizability of these two investments.

Of the adjustment, $.1 million is attributed to the fiscal year ended March 31, 1988 to cover the operating loss of the Corporation for that year. The remaining $3.4 million is attributed to prior years.

11. Jobs Fund Development Agreements and Film Manitoba Loans **$3.2 million**

Accounting Issue: Valuation Allowance

Recommendation: We recommend that in order to reflect the unlikely repayment of forgivable loans of Jobs Fund Development Agreements and Film Manitoba Loans, that a valuation allowance be provided.

Background:

The province's accounting policy for forgiveable loans was changed during 1987 - 88, to require that this type of loan be considered an expenditure in the year it is granted. The change was made on the premise that forgiveness provisions are generally met and the loan is forgiven. Therefore these loans should not be considered an asset of the government. Development Agreement loans totalling $2.9 million were made during 1987 - 88, prior to the policy change. These are now being treated in a manner consistent with the revised policy.

A change was also made, in 1987 - 88, regarding the funding policy for Film Manitoba Loans. Because of the doubtful repayment of these loans, it was decided that they would also be considered an expenditure in the year the loan is granted. The timing of that decision also necessitates an adjustment of $.3 million for loans made, but not converted to the new policy.

12. Manitoba Energy Authority **$3.4 million**

Accounting Issue: Valuation Allowance/Write-off

Recommendation: We recommend that there be a write-off of accumulated costs of the Manitoba Energy Authority.

Background:

The authority had been funded by the province by means of long-term advances. At March 31, 1987, non-recoverable costs incurred by the Authority were written-off leaving a balance of $1.7 million for future recovery. These represent hydro sale negotiations costs, which are considered reimbursable from future export profits under the Manitoba Energy Foundation Act.

During 1987 -88, the Authority incurred further operating costs of $1.7 million. This increased the accumulated costs of the Authority, at March 31, 1988, to $3.4 million.

The recommended write-off of the accumulated costs of the Authority is based on the concern that hydro profits from export sale agreements may not be available through the Energy Foundation to repay the costs incurred by the Authority.

It is also recommended that future operating costs of the Authority be paid from an appropriation of the Consolidated Fund. The write-off of the Authority's accumulated costs is changeable to prior years for the $1.7 million

carried forward at March 31, 1987; and to the fiscal year ended March 31, 1988 for the costs totalling $1.7 million incurred during that fiscal year. The total is $3.4 million.

13. Public Schools Finance Board **$(.8) million**

Accounting Issue: Valuation Allowance

Recommendation: We recommend that an adjustment associated with overfunding of public school support costs be made.

Background:

A review of public schools support costs was considered necessary because an accounting policy change regarding the recording of these costs was implemented during the 1987-88 fiscal year. The review concluded that overfunding of $.8 million had occurred and the required adjustment has been made.

14. North Portage Development Corporation **$ -0-**

Accounting Issue: Valuation Allowance

Recommendation: We recommend no valuation allowance be recorded with respect to the North Portage Development Corporation.

Background:

A review was done to determine any valuation allowance or liability that the province may have from the development of property under this tripartite agreement between the federal government, the province and the City of Winnipeg. We concluded that no valuation allowance or liability needs to be recorded.

15. Other Valuation Allowance Adjustments **$ .6 million**

Accounting Issue: Valuation Allowance

Recommendation: We recommend that valuation allowance or liability adjustments be made in association with the provincial government change in accounting policy which requires that losses be recorded in the fiscal year in which they are incurred.

Background:

A number of additional recommended valuation allowance or liability adjustments result from the change to an accounting policy that requires the recording of operating and loan program losses in the fiscal year in which they

are incurred. The previous policy in effect recorded these losses in the year subsequent to the year of loss. Conversion to the revised policy requires that adjustments for the following losses and (gains) be made in the fiscal year ended March 31, 1988:

► Hazardous Waste Corp.	$ .3 million
► Manitoba Oil and Gas Corp.	.6
► Venture Manitoba Tours	.3
► Channel Area Loggers	.2
► Emergency Interest Rate Relief	.9
► Communities Economic Development Fund	.3
► Manitoba Mineral Resources	(1.5)
► Manitoba Water Services Board	(.5)
	.6

16. Criminal Injuries Compensation Board **$14.9 million**

Accounting Issue: Unrecorded Liability

Recommendation: We recommend that the costs associated with the Criminal Injuries Compensation claims be recorded on an accrual basis and that the associated unrecorded liability be reflected for fiscal year 1987/88 and for prior years.

Background:

The Criminal Injuries Compensation Board makes awards which provide for continuing financial support for citizens harmed by criminal activities. The cost of these awards has been recorded only as the cash has been disbursed. As in a number of other areas, this resulted in a substantial unrecorded liability for awards already approved. An estimate of these liabilities, using the same method of calculation followed at the Workers' Compensation Board, would produce an adjustment of $14.9 million to the recorded liabilities of the province.

We recommend that the costs of awards be recorded as expenditures in the fiscal year the award is made. This change in accounting policy results in a prior year adjustment of $12.3 million; and an increase of $2.6 million in expenditure for the fiscal year ended March 31, 1988.

17. Manitoba Public Insurance Corporation - Reinsurance Assumed **$32.2 million**

Accounting Issue: Unrecorded Liability

Recommendation: We recommend that the unrecorded liability associated with the province's ultimate liability for losses on the Manitoba Public

Insurance Corporation's Reinsurance Assumed activities be recognized as at March 31, 1988.

Background:

The General Insurance Division of the Manitoba Public Insurance Corporation (MPIC) has recorded a cumulative deficit of $32.2 million at October 31, 1987 for its reinsurance assumed operation.

This line of business refers to the practice of one insurance company, called the reinsurer, accepting some component of risk from another (ceding) insurer. The ceding insurer pays a premium to the assuming reinsurer, both for assuming the risks and ultimately sharing in the costs of settling any claims that occur from these risks.

MPIC discontinued reinsurance on November 18, 1987, following several years of heavy losses. It is now in a run-off mode for this line of business. However, due to the long term nature of liability claims from the type of reinsurance contracts signed by the Corporation, claims reporting and claims payments will continue for many years. The consulting actuary estimates a run-off period of 25 years is required.

Since it is certain that the cumulative deficit of $32.2 million at October 31, 1987 cannot be funded from reinsurance assumed earnings, it must be funded by other means. At present, this line is forecast to show a modest profit for the fiscal year 1988. But this will be short-lived as premiums cease and claims payments and administrative costs continue to liquidate the present performing asset base. By mid-1992, the Corporation's consulting actuary forecasts that the investment income will be gone.

We recommend that the province's ultimate liability to pay the losses on reinsurance assumed be recognized as at March 31, 1988. This can be done by recording a liability in the Consolidated Fund for the reinsurance deficit of $32.2 million shown at October 31, 1987. Subsequent to this, it is imperative that a strategy be developed for funding this loss as well as the additional annual requirement, estimated at $750,000, needed to operate the run-off of the business.

18. Manitoba Public Insurance Corporation - Personal and Commercial **$26.9 million**

Accounting Issue: Unrecorded Liability

Recommendation: We recommend that given the unlikely financial recovery of the Manitoba Public Insurance Corporation's Personal and Commercial insurance deficit, that an unrecorded liability be recognized in the Consolidated Fund.

Background:

The General Insurance Division sells a broad range of insurance packages to homeowners, tenants and farmers. These are called "personal" lines. The Division also has a commercial line portfolio which includes insurance coverage to protect business against a wide range of casualty, property, liability, fidelity and surety risks.

At October 31, 1987, the accumulated deficit for the personal and commercial lines was $26.9 million. At present these lines are forecast to show an additional loss of $6.1 million for fiscal 1988.

In addition, based on a "going concern" guideline, this line should have in place a "prudential reserve" for the inevitable range in estimates for insurance losses and catastrophes, the wide fluctuations in loss experience, and to avoid undercapitalization of the business. Insurance industry standards would require a reserve of $9.0 million at October 31, 1987.

The personal and commercial lines continue to lose money. There is no prospect of major improvement without a major rebuilding program over a minimum of three years. Both lines are now in extreme difficulty due to declining numbers of policies in force and related premium base, high and proportionately increasing operating expenses and no performing asset base to produce investment income as an off-set against claims losses. The financial performance of these two lines indicate the need for significant accounting recognition of the situation in the Consolidated Fund.

We recommend that a liability for the October 31, 1987 deficit of $26.9 million be recorded in the Consolidated Fund as at March 31, 1988. If it is the intention to continue the operation of these two lines, a contingent liability of $9.0 million for the required "prudential reserve" should also be disclosed in the books of the province.

19. Workers' Compensation Board **$16.4 million**

Accounting Issue: Unrecorded Liability

Recommendation: We recommend that an unrecorded liability be represented in the provincial government account. This is associated with the interest forgone as a result of cabinet orders issued in the years 1983-87 which limited the assessment increases proposed by the Worker's Comensation Board.

Background:

In recent years, because the cost of compensation awards has exceeded the assessments on employees who contribute to the fund, the Workers' Compensation Board has reported a significant unfunded liability. The Workers' Compensation Board is intended to be a self-funding corporation independent of

government influence in day-to-day operations and independent of government financial support.

Section 66 of the Act provides for the Board to raise the funds it requires from employers, to create and maintain the Accident Fund, and to pay for the costs of administration.

However, we were informed that in the years 1983 through 1987, the government declined to allow the Workers' Compensation Board to raise the assessments required to adequately provide for the Accident Fund as per Section 66.

While there is no legal responsibility for the government to pay the assessments lost to the fund as a result of the rate setting process, we recommend that the government take responsibility for interest lost to the fund.

The loss of interest for the period 1983 through 1987 has been calculated at $16.4 million. We recommend that this be recorded as a liability at March 31, 1988. It should be considered a one time payment to assist the Board in its general program to strengthen its financial position. We have determined that there is precedent and legal authority for the government to make such a one time payment. In 1984, a payment of $4 million was made to the Board to defray "unanticipated costs for which inadequate funding provision has been made". The Department of the Attorney General advises that there is legal authority for such a payment. This step will reduce the amount to be collected from employer assessments.

20. Manitoba Development Corporation (Divestiture of Flyer Industries) **$5.8 million**

Accounting Issue: Unrecorded Liability (Provision for Warranty Costs)

Recommendation: We recommend that there be an increase in the estimated provision for warranty expenses associated with the divestiture of Flyer Industries Ltd.

Background:

As part of the July, 1986 divestiture of Flyer Industries Ltd., the provincial government, via the Manitoba Development Corporation, assumed the liabilities of Flyer Industries Ltd. It made certain payments on behalf of Flyer Industries Ltd. and issued certain guarantees to New Flyer Industries Ltd. Included in the assumption of liabilities was the liability for warranty claims on Flyer buses.

The divestiture agreement of July 15, 1986 establishes that warranty costs resulting from buses manufactured by Flyer Industries Limited are the responsibility of the Manitoba Development Corporation. The Manitoba

Development Corporation took on this obligation as one of the terms of the sale. Accordingly, a provision for warranty costs was established in the accounts of the Corporation at the time of divestiture. It has been increased annually as required by warranty claims experience.

Historically, Flyer Industries issued two types of warranties: a general warranty of normally one year or 50,000 miles, and a design or structural warranty of generally three years, but up to five and ten years for certain contracts. It is with respect to the design warranties that significant exposure to the Manitoba Development Corporation has existed and continues to exist.

We have reviewed the increased provision proposed by the Manitoba Development Corporation in its preliminary financial statements for March 31, 1988. We recommend that an additional $2.2 million be provided. This will increase the divestiture loss recorded by the Corporation in the fiscal year ended March 31, 1988 to $5.8 million.

Under the government's previous valuation allowance policy, this loss would not have been recorded until the fiscal year ended March 31, 1989. We also recommend that this policy be changed so that valuation allowance losses are recorded in the expenditure accounts of the government in the year the loss has been incurred. This results in an increase of $5.8 million for expenditures recorded in the fiscal year ended March 31, 1988.

21. External Agencies **$ .2 million**

Accounting Issue: Unrecorded Liability

Recommendation: We recommend that a liability adjustment be recorded in the province's accounts with respect to external agencies.

Background:

This review was concerned with actual or potential obligations of the province resulting from operating deficits incurred by agencies funded through government grants or transfer payments. The review focused primarily on grants administered by the Departments of Community Services and Corrections, Employment Services and Economic Security and Culture, Heritage and Recreation (excluding Lotteries). Grants totalling $83.1 million to 69 agencies were reviewed. The review identified $.2 million of unfunded deficits at Tarch 31, 1988 that should be recorded as liabilities at that date for the Department of Community Services and Corrections.

In addition, our review revealed that the Child and Family Services Act is generally perceived to allow significant financial obligations to be incurred by external agencies without prior government approval. We see this as an area for further urgent review. Such a review would identify and define specific measures to improve the accountability, financial control and comparability of service unit costs, of each agency type.

22. Manitoba Properties Inc. — $601.1 million

Accounting Issue: Consolidation - Reporting Entity

Recommendation: We recommend that in order to more fairly present the financial position of the province with respect to the government services being provided by Manitoba Properties Inc.(MPI), that the accounts of MPI be consolidated with the Operating Fund.

Background:

Manitoba Properties Inc. is a public company, acquired in July, 1984, for the purpose of enabling the province to raise $399.1 million through the issue of preferred shares. The province sold most of its land and buildings to MPI and entered into a lease agreement for these properties. The interest cost on funds raised through the issue of preferred shares rather than issuing debt, has resulted in an annual savings of $11 million to the province. Since MPI was established primarily to provide services to the government, the question of consolidation with the government's accounts has existed from the date of the property sale. While the Summary Financial Statements of the province describe the effect of Consolidation, this has not completely satisfied the Provincial Auditor regarding presentation in the government's accounts of capital expenditures made through MPI. The Provincial Auditor's report on the 1986 - 87 Public Accounts contained a qualification wherein the capital expenditures incurred by MPI were added to the government's deficit for the year.

We recommend that the accounts of MPI be consolidated with the Operating Fund for the year ended March 31, 1988. We believe that such a consolidation will more fairly present the financial position of the province in the Summary Financial Statements. The following is a summary of the net effect of consolidation on the March 31, 1988 financial statements:

a) The province's assets are reduced by $202.0 million as the result of the elimination of promissary notes issued by MPI to the province.

b) Direct debt of the province is increased by $309.1 million to reflect the outstanding preferred shares of MPI.

c) The deficit for the fiscal year ended March 31, 1988 is increased by $8.7 million for capital expenditures and other costs incurred through MPI.

d) The deficit of prior years is adjusted by $592.4 million to eliminate entries previously made for the sale of land and buildings and to account for prior year expenditures of MPI.

23. Civil Service Pensions

Accounting Issue: Unrecorded Liability

Recommendation: An unrecorded liability of over $1.1 billion exists with respect to the province's responsibility for its share of pension costs. The magnitude of this financial obligation and its potential impact on Manitobans make it a critical issue for government.

We have concluded that, until the matter of accurately estimating this liability and the design of an acceptable plan for funding can be determined, no provision be made in the provincial accounts in 1987-88 or 1988-89. We do recommend, however, that this situation and the issues requiring further study be given immediate attention by the Minister of Finance and his colleagues, with appropriate input from involved parties.

Background:

The government of Manitoba does not account for or fund its obligation for the future pension benefits of current and retired civil servants, teachers and Members of the Legislative Assembly. The government operates, as do almost all other provinces, on a "pay as you go" basis. The government pays its portion of the pensions as they become due to individuals upon their retirement. Civil servants and teachers, on the other hand, contribute their part to the pension funds while employed.

These pensions are known and predictable future obligations of the government, just like any other liability. The cost is incurred when the pension is earned each year the individual is employed. By not recording the cost and obligation and then setting aside specific funds for pensions **and investing them so that they earn a return**, the government is in effect borrowing these funds. This burdens future rather than present governments and taxpayers with the unrecognized cost of the pensions. It also significantly increases the eventual future cost of the pensions, which must then be paid by future taxpayers.

To 1961 the government of Manitoba had funded its share of pension contributions, i.e. paid for them as they were earned. Since then, it has left them unfunded. Exhibit IV-2 dramatically portrays the disparity between employee contributions and government (employer) payments. The result --an unrecorded and unfunded liability estimated at about $1.17 billion.

We have considered the following key issues in formulating our recommendations:

- Accounting for and funding these pension costs has become extremely difficult, because of their magnitude.

- The provincial auditor has been pressing the government to account for the cost of pensions by recognizing the accumulated liability in the government's financial statements and by charging the annual cost as an expenditure in that year. At present, this liability is only disclosed in a note to the financial statements.

- The Public Sector Auditing and Accounting Committee (PSAAC) of the Canadian Institute of Chartered Accountants is expected to issue a standard for reporting pension costs this fall. As of now, however, no accounting standard exists for government pensions. If, as seems likely, the PSAAC standard requires reporting of pension costs, and if the government continues not to account for pension costs, the Provincial Auditor will be in a position to qualify his opinion on the public accounts.

- There is growing concern among Canadians about the security of their retirement, owing to a lack of public sector funding of their pensions.

In principal, we therefore recommend that the government begin accounting for public sector pensions on a current basis, and develop an action plan with clear targets for dealing with the funding problem. This is the best course to both portray accurately the province's financial position and safeguard the security of future pension benefits.

To institute this, we recommend that further examination to resolve measurement and funding issues be immediately initiated by the Minister of Finance and his colleagues with appropriate input from involved parties.

24. Civil Service Employee Benefits

Accounting Issue: Unrecorded Liability

Recommendation: We recommend further examination with respect to unrecorded liabilities associated with employee benefits.

Background:

Significant unrecorded liabilities exist with respect to certain employee benefits -- sick leave, vacation entitlement and workers' compensation. While it is desirable to record these liabilities as at fiscal year end, determination and capture of these liabilities will require considerable systems development. In addition, it is likely that the impact of the change in the liability from year to year will be minimal. It is therefore recommended that further study be instituted to measure and capture unrecorded liability in data as it relates to employee benefits.

Stevenson Kellogg Ernst & Whinney

EXHIBIT IV-1
Recommended changes in valuation allowances and liability adjustments

	At March 31, 1988		Adjustments to Expenditures or Deficit	
	Write-down of assets or Valuation Allowances	Liability Adjustment	Fiscal Year March 31, 1988	Prior Years
	(millions)			
1. Foreign Exchange				
Principal		193.2	(11.6)	204.8
Interest		20.1	2.2	17.9
Debt Issue Costs	(.5)		(.5)	
	(.5)	213.3	(9.9)	222.7
2. Valuation Allowances and Other Provisions				
Manitoba Housing & Renewal Corporation	11.4		4.5	6.9
Manfor Ltd.	127.1			127.1
Manitoba Agricultural Credit Corporation	10.6		10.6	
Manitoba Beef Commission	(8.0)		(8.0)	
Manitoba Potash Corporation	5.4		5.4	
Business Loans and Investments	0			
Venture Capital Program	1.0		1.0	

EXHIBIT IV-1 (continued)
Recommended changes in valuation allowances and liability adjustment

	At March 31, 1988		Adjustments to Expenditures or Deficit	
	Write-down of assets or Valuation Allowances	Liability Adjustment	Fiscal Year March 31, 1988	Prior Years
	(millions)			
2. Valuation Allowances and Other Provisions (continued)				
Hudson Bay Mining & Smelting -- Ruttan Mine	9.0		9.0	
Leaf Rapids Town Properties Ltd.	3.5		.1	3.4
The Jobs Fund				
- Development agreements	2.9		2.9	
- Film Manitoba Program	.3		.3	
Manitoba Energy Authority	3.3	.1	1.7	1.7
Public School Finance Board		(.8)	(.8)	
North Portage Development Corporation	0			
Hazardous Waste Corporation	.3		.3	
Manitoba Oil and Gas Corporation	.2	.4	.6	
Venture Manitoba Tours	.3		.3	
Channel Area Loggers		.2	.2	
Emergency Interest Rate Relief	.9		.9	
Communities Economic Development Fund		.3	.3	
Manitoba Mineral Resources	(1.5)		(1.5)	
Manitoba Water Services Board	(.5)		(.5)	
	166.2	.2	27.3	139.1

EXHIBIT IV-1 (continued)
Recommended changes in valuation allowances and liability adjustment

	At March 31, 1988		Adjustments to Expenditures or Deficit	
	Write-down of assets or Valuation Allowances	Liability Adjustment	Fiscal Year March 31, 1988	Prior Years
	(millions)			
3. Unrecorded Liabilities				
Criminal Injuries Compensation Board		14.9	2.6	12.3
Manitoba Public Insurance Corporation				
- Reinsurance assumed		32.2	32.2	
- Personal and Commercial		26.9	26.9	
Workers Compensation Board		16.4	16.4	
Manitoba Development Corporation (Divestiture of Flyer Industries)		5.8	5.8	
External Agencies		.2	.2	
	--	96.4	84.1	12.3
4. Consolidation Reporting Entity				
Manitoba Properties Inc.	202.0	399.1	8.7	592.4
TOTAL ADJUSTMENTS	367.7	709.0	110.2	966.5

EXHIBIT IV-1 (continued)
Recommended changes in valuation allowances and liability adjustment

	At March 31, 1988		Adjustments to Expenditures or Deficit	
	Write-down of assets or Valuation Allowances	Liability Adjustment	Fiscal Year March 31, 1988	Prior Years
	(millions)			

5. Recommended for Further Study

a) Pensions

Our report indicates that the total unfunded liability at December 31, 1987 was approximately $1.17 billion. The annual costs of pensions paid out in 1987/88 fiscal was $131 million, offset by $50 million in payments into the fund. The major problem is that since 1961 the Province has not paid its share of employees' pensions into the Pension Fund; nor has this liability been accounted for in the financial accounts. Due to a number of factors set out in our report, we have concluded that no provision can be made in the accounts in 1987/88 or 1988/89 until the whole matter of accurately estimating the liability and an acceptable plan for funding have been determined. The issues relating to pensions have been set out in our report.

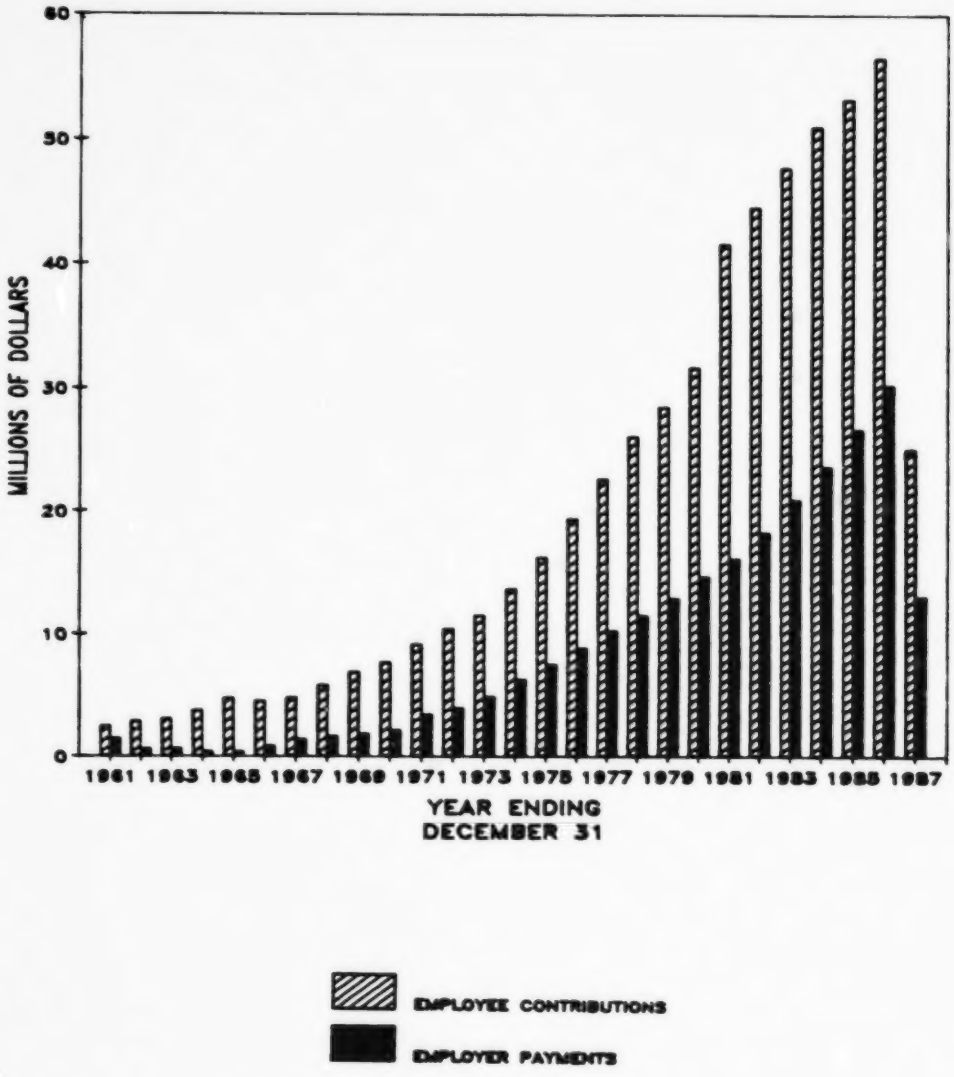
b) Other Employee Benefits

A preliminary study of other employee benefits indicates that significant unrecorded liabilities exist in the following areas:

1. Sick Leave - estimated contingent liability is $220 million. The actual liability would be lower and requires an actuarial study to determine the expected use of these credits.
2. Vacation Entitlement - estimated at $35 - $45 million.
3. Workers Compensation - WCB would require an actuarial evaluation to accurately determine the Province's liability for provincial employees on long term compensation.

While it is desirable to record these liabilities as at fiscal year end, the impact of the change in the liability from year to year will be minimal. A determination of these liabilities will require considerable systems development.

EXHIBIT IV-2
Civil Service Superannuation Fund
Teacher's Retirement Allowance Fund
Employee - Employer Contributions



(1987 DATA - C.S.S.F. PAYMENTS ONLY)